

**U. S. House of Representatives
Committee on Transportation and Infrastructure
Railroads Subcommittee**

Statement for the Record - May 10, 2006

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Chairman, Railroad Retirement Board**

Good afternoon, Chairman LaTourette, Ranking Member Brown, and distinguished members of the Committee. My name is Michael S. Schwartz and I am Chairman of the Railroad Retirement Board. I am here today with V. M. Speakman, Jr., Labor Member of the Railroad Retirement Board, and Jerome F. Kever, Management Member of the Railroad Retirement Board. It is indeed a pleasure to appear before you today to testify on behalf of the Railroad Retirement Board concerning our experience under the Railroad Retirement and Survivors' Improvement Act.

As you know, the Railroad Retirement and Survivors' Improvement Act of 2001 originated in this committee, and it made a number of changes in railroad retirement benefits and in the financing of the railroad retirement program. The Railroad Retirement and Survivors' Improvement Act of 2001 was the product of an agreement between railroad labor and railroad management. On the benefit side, the 2001 Act reduced the minimum retirement age for full benefits for employees with 30 years of service from age 62 to age 60. Another change was the elimination of the so-called railroad retirement maximum, which had imposed a cap on the combined benefits of an employee and the employee's spouse. The Act added a new minimum initial benefit amount for widows and widowers so that the amount of the benefit payable when a

widow's or widower's annuity is awarded is equal to what the employee received prior to his or her death. Another change on the benefit side was a reduction in the number of years needed to be eligible for tier II railroad retirement benefits. Tier II benefits are now available to employees who have 5 years of railroad service after 1995. These changes are all fully operational.

In addition to the benefit changes I just mentioned, the Railroad Retirement and Survivors' Improvement Act of 2001 made significant and far-reaching changes in the financing of railroad retirement benefits. The Act called for the creation of a new entity, the National Railroad Retirement Investment Trust, to handle investment of railroad retirement funds. The Trust is not a Federal agency or instrumentality and is separate and apart from the Railroad Retirement Board. Prior to the 2001 legislation, railroad retirement funds were invested only in government securities or certain government-backed securities. The 2001 law changed this by authorizing the Trust to invest railroad retirement funds in a wide array of investments, including stocks and bonds, as well as government securities. In addition to the investment changes, the Railroad Retirement and Survivors' Improvement Act of 2001 substituted for the flat tax rates in prior law, a new tax ratchet mechanism for setting the tier II tax rate for employers and employees. Under the tax ratchet, tier II tax rates for employers and employees can increase or decrease depending on the account benefits ratio. The account benefits ratio is determined by comparing the market value of railroad retirement assets to benefit payments. Thus, the tax rate is adjustable to meet the financing needs of the railroad retirement system.

Almost immediately after President Bush signed the Railroad Retirement and Survivors' Improvement Act of 2001 into law on December 21, 2001, steps were initiated to form the National Railroad Retirement Investment Trust. The Trust is comprised of seven Trustees. Three Trustees represent the interests of railroad management. Three Trustees represent the interests of railroad employees. The seventh Trustee is the independent member of the Board of Trustees and is selected by a majority of the other six Trustees. Trustees representing railroad employees and railroad management were appointed and first met on February 1, 2002. The original Trustees, as well as Trustees who have been appointed after the Trust was formed, all have had strong backgrounds in investment and pension plan management, as required by the statute.

The first transfer of funds for investment occurred in September 2002. For several months thereafter, additional transfers of significant amounts were made until a total of about \$21.3 billion had been transferred to the Trust. Initially, the Trust limited its investments to index funds, but as the Trust's staff has grown, the Trust has moved funds into a combination of index funds and actively managed investments handled by an increasing number of investment managers. Today, the Board of Trustees and the Trust's professional staff are responsible for investment of \$28.9 billion of railroad retirement funds.

Although the Railroad Retirement and Survivors' Improvement Act of 2001 makes it clear that the Railroad Retirement Board and the National Railroad Retirement

Investment Trust are separate entities, the responsibilities of the two organizations are such that the Board and Trust must work together in order to serve the needs of the plan participants and stakeholders. Today, I am pleased to report that the Board and the Trust have worked closely from the inception of the Trust and that we are accomplishing our respective responsibilities under the Act. The three Members of the Railroad Retirement Board meet at least twice each year with the Board of Trustees and the Railroad Retirement Board's General Counsel meets on a frequent basis with the Counsel to the Trust and the Trust's Chief Investment Officer to discuss issues of mutual concern. The Railroad Retirement Board, the Trust, the Office of Management and Budget, and the Department of the Treasury, are all parties to a Memorandum of Understanding under which the Board receives monthly reports from the Trust showing the market valuation of the Trust's portfolio. Moreover, the Trust provides the Board with copies of its annual management report to Congress showing details of the Trust's operations for the previous fiscal year. The Railroad Retirement Board receives quarterly updates of the annual report from the Trust. Information about the Trust, including the annual management report and quarterly updates, is posted to the Railroad Retirement Board's website and is available for public review.

Since the inception of the Trust, the market value of the Trust's portfolio has increased significantly. As I noted earlier, the Railroad Retirement Tax Act was amended by the 2001 law to provide a tax ratchet mechanism for setting Tier II tax rates for employers and employees. Before the tax ratchet became effective in 2004, the 2001 Act had already reduced the tier II tax rate on employers from 16.1% in 2001 to 15.6% and 14.2%

in 2002 and 2003, respectively. When the tax ratchet took effect in 2004, the employer tax rate was further reduced to 13.1%, and in 2005, both the employer and employee tier II tax rates were reduced. In 2005, the employer tax rate declined to 12.6% and the employee tax rate declined from 4.9% to 4.4%. The tax rates for 2006 are the same as applicable in 2005. These reductions in the tier II tax rates for both employers and employees were almost entirely the result of good investment performance over the past few years.

In closing, I would like to say that, in the view of the Railroad Retirement Board, the Railroad Retirement and Survivors' Improvement Act of 2001 has been very successful and that the goals sought by the legislation are being achieved.

We would be happy to answer any questions the committee may have.